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Misconduct in the Banking, Superannuation and Financial Services Industry

Submission to the Royal Commission

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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INTRODUCTION

The revelations of misconduct from the first four rounds of hearings have been shocking. Across every sector of the financial services industry – from consumer lending to financial advice to insurance –banks and other entities have shown flagrant disregard for both the law and the needs of their customers.

In looking at issues across the financial services sector, one overriding problem emerges – there are lengthy and unnecessary delays to solutions to help consumers. There are delays as financial services providers deny any problem is occurring and there are excessive delays as industries pursue ineffective self-regulatory options. These self-regulatory initiatives either fail to deliver anything, like we have recently seen with the Insurance in Superannuation Working Group. Or they address only those issues which industry feel comfortable tackling, not the root cause of problems, as we're seeing with the Combined Industry Forum into mortgage broking.

Self-regulation as a first response in the financial services sector has demonstrably failed, leading people to suffer significant loss. It is time for a re-think on how we can best rapidly respond to issues as they are identified by better arming our regulators and moving to a code development process that doesn't let industry write their own rules.

The pursuit of profit over all other things has been a leading cause of this misconduct. A culture of selling-at-all-costs permeates every layer of entities, from front-line staff who are rewarded for selling products, to managers who are promoted and lauded for achieving sales targets, right up to executives who receives bonuses for achieving company-wide financial targets.

It is time to rethink what the purpose of financial services is in Australia. When dealing with consumers, financial services entities must deliver on their promises and foster the long-term financial wellbeing of their customers. Remuneration practices must be reformed. The law should be simplified to remove loopholes for conflicted remuneration, the executive accountability regime must be expanded , mortgage brokers must be required to act in the best interests of their customers and not just paid to sell, and conflicted payments like asset-based fees must finally come to an end. These reforms will force the industry to shift their focus away from aggressive and often misleading sales practices to serving customers.

To complement these reforms, we need to empower and support our regulators, not tear them down. Financial services entities have treated breaching laws and the risk of getting caught as simply the cost of doing business. To deter future misconduct, we need to empower ASIC with an increased penalties regime. The regulator's compliance and enforcement toolkit also needs

to be expanded to better enable ASIC to investigate and take action in instances where the law has been breached. We need mandated consumer representation in our regulators to ensure that the interests of those who are directly affected are heard. These reforms, taken holistically, will address the sources of misconduct and build a financial services sector that is fit for purpose, meets community expectations and contributes to the welfare of Australians.

Recommendations

Recommendation 1

- Give ASIC the capacity to administer mandatory industry codes to allow code development and reviews to be conducted by an independent party.
- If this option is not pursued, progress with the co-regulatory model for the insurance sector, as proposed in Chapter 4 of the final report of the ASIC Enforcement Review Taskforce. Under this model:
    - Codes should require ASIC approval and be subject to monitoring;
    - All industry participants should be required to subscribe to an ASIC approved code;
    - In the event of non-compliance with a code, an individual customer should be entitled to seek appropriate redress through the participant's internal and external dispute resolution arrangements; and
    - Failures to comply with codes should constitute a failure to comply with section 912A of the *Corporations Act 2001* and other ASIC-administered legislation.[1]

Recommendation 2

- Remove up-front commissions for mortgage brokers and replace these with fixed fees for service to better serve the needs of consumers. These fixed fees could either take the form of lump sum payments or rates based on hours of work required to arrange a loan.

Recommendation 3

- Ban mortgage brokers from receiving trail commissions for arranging home loans.

Recommendation 4

- Amend the National Consumer Protection Credit Act 2009 so that all mortgage brokers have to act in the best interests of their clients. This should mirror the obligations for financial advisers in the Corporations Act 2001.

Recommendation 5

- Ban commissions paid to introducers.

Recommendation 6

- Brokers and aggregators should be required to disclose, in plain English:

[1] The *Australian Securities and Investments Commission Act 2001*, *National Consumer Credit Protection Act 2009* and *Competition and Consumer Act (2010).*

- the number of lenders available to the customer, the number of lenders that broker has used in the last year and the top six lenders and percentage of business written in the last year;
- how much the broker will be paid for arranging the loan with different lenders;
- any ownership relationships between lenders and the aggregators.

Recommendation 7

- That the BEAR framework be expanded in three important ways:
  - to include conduct regulation;
  - to extend ‘accountable persons’ to include senior managers responsible; and
  - to extend the scope to include insurers and non-prudentially regulated firms.

Recommendation 8

- Expand proposed product intervention powers for ASIC to include remuneration practices that risk encouraging behaviour that is likely to result in consumer detriment.

Recommendation 9

- Ban ongoing fees for financial advice and replace these with a fixed fee for service.

Recommendation 10

- Cease grandfathered commissions.

Recommendation 11

- Ban asset-based fees in financial advice.

Recommendation 12

- Prevent fees associated with financial advice platforms from being automatically deducted from a client’s platform account, without the express consent of the client.

Recommendation 13

- Introduce a legal obligation for financial advisers to offer a range of platform providers, of different ownership structures.

Recommendation 14

- Ban commissions in the life insurance industry.
  - At a minimum, the exceptions for general insurance and life risk insurance should be removed from the ban on conflicted remuneration in Division 4 of Part 7.7A of the *Corporations Act 2001*.

Recommendation 15

- That the Federal Government urgently act on the recommendation of the ASIC Enforcement Taskforce Review to expand the civil penalty regime.
  - Obligations in section 912A of the *Corporations Act 2001* must apply to all aspects of the provision of insurance, including the handling and settlement of insurance claims.

Recommendation 16

- That the Federal Government urgently act to increase penalties across all ASIC-administered legislation to the same level.
  - For corporations, penalties should be raised to be the greater of 50,000 penalty units (currently $10.5 million), three times the value of benefits obtained or losses avoided or 10% of annual turnover in the 12 months preceding the contravening conduct.
  - Penalties should not be capped in a way that limits them from acting as an effective deterrent, i.e. at a minimum, penalties for breaches must at least equal the value of the benefits obtained or losses avoided. If this figure cannot be calculated, penalties should be the greater of 50,000 penalty units or 10% of annual turnover in the 12 months preceding the contravening conduct.

Recommendation 17

- ASIC and APRA should be appropriately resourced to support increased volumes of litigation.

Recommendation 18

- All of the recommendations of the ASIC Enforcement Taskforce Review should be implemented in full, as a matter of urgency.

Recommendation 19

- The Commission recommend establishing a compensation scheme of last resort in line with the findings of the Ramsay Review

CHOICE

1. Reforming banking and financial services culture

The culture of banks has been scrutinised by the Royal Commission, and offered as a partial explanation for the systemic non-compliance and dishonest behaviour exhibited by industry.[2] Part of the cultural deficiencies of banks and other financial services has been their failure to consider their obligations not only under the law, but to their customers and the community more broadly. For example, on the subject of consumer lending the Royal Commission says that "to preserve and enhance a reputation for engaging in the enterprise's activities efficiently, honestly and fairly, the enterprise must do more than not break the law. It must seek to do 'the right thing'".[3] This suggests that new laws are themselves inadequate to address cultural problems, as the Royal Commission's Interim Report goes on to explain: "Good culture and proper governance cannot be implemented by passing a law. Culture and governance are affected by rules, systems and practices but in the end they depend upon people applying the right standards and doing their jobs properly".[4]

However, the persistent failures of self-regulation illustrate that companies cannot be trusted to fix their culture on their own accord. The leading example is the years it took and the human suffering caused by industry's failure to standardise a single term within insurance contracts. The industry's failed attempt to come up with a standard definition for "flood" directly led to human suffering and uncompensated loss of homes during the devastating Queensland floods of 2010-11. After years of industry delay, government action was eventually required to define a single word. We cannot expect industry to continue to set and enforce their own rules that run counter to their commercial interests. Instead, independent processes and actors must hold the secotr accountable.

Companies have repeatedly pledged to address cultural problems. Despite this, there has been little discernible progress. For example, after the collapse of the Storm Financial Group, the Commonwealth Bank (CBA) opposed major regulatory reform and announced a number of internal changes which it claimed addressed its shortcomings.[5] General Counsel for CBA, David Cohen, testified before the Joint Parliamentary Committee on Corporations and Financial Services in September 2009 that:

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[2] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, Volume 1, p.345

[3] Interim Report, p.91

[4] Interim Report, p.321

[5] Commonwealth Bank provided financial products via Storm to their clients in order to realise Storm's financial advice.

> "In terms of our learnings, the bank has learned from mistakes that we have made in relation to some of our lending to Storm customers. Amongst the steps we have taken to remedy the situation, we have improved our valuation decisioning tool, known as VAS, which I am sure the committee has heard about, we have tightened our loan approval processes, and we have augmented our compliance and audit checking processes. We will be doing everything possible, and I can assure the committee of this, to ensure that the mistakes we have made in the past do not occur again."[6]

A month later, then-CEO of CBA, Ralph Norris, continued to reassure the same Parliamentary Committee that the bank had "put in place a number of very structured processes that have established a very good sales and service system".[7] However, these measures did not stop the bank from becoming embroiled in yet another financial planning scandal, for which it again apologised in 2014.[8] As the Interim Report notes, CBA would issue other apologies and pledges for change following the CommInsure scandal in 2016[9] and the investigation into money laundering by the Australian Transaction Reports and Analysis Centre in 2017.[10] The bank also apologised earlier this year following revelations from the Royal Commission itself and the Prudential Inquiry Final Report from the Australian Prudential Regulation Authority.[11] The bank also apologised in March after it was revealed thousands of Dollarmite accounts were fraudulently opened by branch staff in order to meet sales targets and receive bonuses.[12]

Apologies haven't changed culture or stopped the scandals.

Self-regulation cannot continue

It is clear that self-regulation has failed consumers. Industry codes have proven to be inadequate in minimising consumer detriment. industry codes lack regulatory oversight and monitoring. In fact, only two of the eleven codes in the financial services industry has been

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[6] Inquiry into Financial Product and Services in Australia, Joint Commitee on Financial and Services, 4 September 2009 https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id:committees/commjnt/12379/0005

[7] Inquiry into Financial Product and Services in Australia, Joint Commitee on Financial and Services, 4 September 2009

[8] CBA Media Release, 2014, "https://www.commbank.com.au/about-us/news/media-releases/2014/statement-to-our-customers-from-ian-narev.html

[9] CBA Media Release, 2016, https://www.commbank.com.au/about-us/news/media-releases/2016/ian-narev-ceo-statement-on-life-insurance.html

[10] CBA Media Release 2018, https://www.commbank.com.au/guidance/newsroom/CBA-and-AUSTRAC-resolve-AMLCTF-proceedings-201806.html?ei=gsa_newsroom_AUSTRAC-apologise

[11] CBA Response to APRA Prudential Inquiry Report 2018, https://www.commbank.com.au/personal/newsroom/apra.html?ei=gsa_generic_newsroom-apologise

[12] ABC News, 'Commonwealth Bank admits to manipulation of children's accounts', 19 May https://www.abc.net.au/news/2018-05-19/commonwealth-bank-staff-manipulated-childrens-accounts/9779010

formally approved by ASIC and only one of these currently applies to industry.[13] Second, compliance with industry codes is largely voluntary and not all firms in a subsector will subscribe to the relevant codes. Finally, code development is currently run by industry, for industry. While consumer groups and regulators may be consulted, their capacity to influence decisions is often constrained. Industry are still making the primary decisions about what is covered in codes and how it will be addressed. Even if significantly reformed, industry codes will still fail to protect many consumers in the industry.

We believe that codes can play an important role in protecting consumers and lifting industry standards. In order to be effective, codes must:

- Be led by an independent party and shaped by consumer needs rather than industry preferences.
- Be supported by accurate and unbiased research into the problems they seek to solve.
- Be developed by asking the right questions of industry, i.e. how protections could be operationalised rather than whether protections should be implemented at all.

Co-regulation: a small evolution for the code making process

At a minimum, code development processes could be evolved to a co-regulatory model as proposed in Chapter 4 of the final report of the ASIC Enforcement Review Taskforce. As the Taskforce explains:

> *ASIC can achieve greater regulatory oversight through a co-regulatory model by exercising its power to approve codes. Under such a co-regulatory model codes would remain industry-led and not mandated by legislation, but would require ASIC approval and be subject to monitoring. Under this model, industry participants would be required to subscribe to an ASIC approved code, and in the event of non-compliance with the code, an individual customer would be entitled to seek appropriate redress through the participant's internal and external dispute resolution arrangements.*[14]

It should be noted that this option still leaves industry to lead development of codes. It does not deal with the conflict at the heart of self-regulation: that industry has little interest in addressing problems it is currently profiting from.

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[13] The Financial Planning Association Professional Ongoing Fees Code and the ABA's Banking Code of Practice, approved by ASIC to commence from mid-2019 https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-223mr-asic-approves-the-banking-code-of-practice/

[14] The Treasury, 'ASIC Enforcement Review Taskforce' December 2017, p. 31. https://static.treasury.gov.au/uploads/sites/1/2018/04/ASIC-Enforcement-Review-Report.pdf

The Federal Government's response to the Taskforce agreed in principle with its recommendation to move to a co-regulatory model.[15] However, the Government also deferred implementing the recommendations to enable it to take account of findings arising out of the Royal Commission.

Under the co-regulatory model, all financial institutions would have to subscribe to the relevant code for their category of business. Compliance with the codes would be monitored by monitoring bodies comprised of industry, consumer and expert members. This body would need adequate resources to conduct its job properly, something that hasn't always occurred in practice. Insurers would be required to report periodically to the monitoring body, which would be able to refer companies to ASIC. In order for this to be effective, codes must have roots in legislation to provide remedies to both consumers and regulators in instances of non-compliance. Therefore, CHOICE supports making failures to comply with codes a failure to comply with section 912A of the *Corporations Act 2001* and other ASIC-administered legislation.[16]

A stronger option - code development by a regulator acting in consumer interests

Co-regulation is unlikely to solve the deep and persistent problems uncovered by the Royal Commission. This model still leaves key decisions and processes in the hands of industry groups, typically the parties that commercially benefit from current practices and have little incentive to support change. The code development process needs greater independence to really address problems.

Strong co-regulation should involve independent development and reviews of codes.[17] However, these processes typically feed back to an industry group to make the decision final reforms, such as occurred with the latest version of the ABA's Banking Code of Practice where several independent recommendations weren't progressed.

The content of codes should not remain up to industry to determine. Instead, a better option when issues are raised would be for ASIC to administer codes of conduct, similar to how it

[15] The Australian Government, 'Australian Government response to the ASIC Enforcement Review Taskforce Report' April 2018, pp. 5-6.
[16] The *Australian Securities and Investments Commission Act 2001*, *National Consumer Credit Protection Act 2009* and *Competition and Consumer Act (2010).*
[17] For example, as outlined in the Consumer Federation of Australia's Good Practice Principles for code development http://consumersfederation.org.au/wp-content/uploads/2018/05/Guidelines-Codes-EDR-Schemes.pdf

oversees the e-payments code.[18] With this code, ASIC has the power to initiate and conduct regular reviews. The regulator is in charge of steering discussion about reform, rather than industry. ASIC also has the power to monitor and enforce the code, although this could equally be done by code compliance committees, as under the co-regulatory model. Ultimately, for a code to successfully address issues, it needs to be initiated, led and delivered by a party truly independent from industry.

Recommendation 1

- Give ASIC the capacity to administer mandatory industry codes to allow code development and reviews to be conducted by an independent party.
- If this option is not pursued, progress with the co-regulatory model for the insurance sector, as proposed in Chapter 4 of the final report of the ASIC Enforcement Review Taskforce. Under this model:
    - Codes should require ASIC approval and be subject to monitoring;
    - All industry participants should be required to subscribe to an ASIC approved code;
    - In the event of non-compliance with a code, an individual customer should be entitled to seek appropriate redress through the participant's internal and external dispute resolution arrangements; and
    - Failures to comply with codes should constitute a failure to comply with section 912A of the *Corporations Act 2001* and other ASIC-administered legislation.

2. Reforming remuneration

CHOICE welcomes the Royal Commission's assertion that "the culture and conduct of banks was driven by, and was reflected in, their remuneration practices and policies".[19] The current structure of remuneration largely incentivises a selling-at-all-cost mentality for entities. The sector must abandon short-term incentives to reduce consumer harm.

Decisive action is clearly required to address bank behaviour. This CHOICE firmly believes that this can be accomplished by reforming the incentive structures in place for banks. Banks are not seeking to 'do the right thing' because there are not sufficient incentives to do the right thing, and conversely there are not sufficient disincentives for doing the wrong thing. Culture is an

[18] See ASIC Enforcement Review Taskforce, p. 33
[19] Interim Report, p.340

important part of why the financial services industry has failed consumers, but it is itself a symptom of a broader problem that can be addressed through reform to incentive structures.

There are three elements to reforming incentive structures. First is remuneration. As the Interim Report notes, culture has been ‘driven by’ remuneration practices.[20] However, reforms to remuneration practices must be partnered with penalties and enforcement.

Reforming the mortgage broker industry

CHOICE strongly supports the Interim Report’s conclusion that:

> “*what is plain, however is that value- and volume-based remuneration for intermediaries in the home loan industry has been an important contributor to misconduct and conduct falling short of community standards and expectations and poor customer outcomes.*”[21]

What is also plain is the solution. Commissions in the mortgage broking industry need to be banned. CHOICE strongly supports reform to the remuneration of mortgage brokers and introducers in the industry.

Brokers cannot continue to be paid by lenders while pretending to act for customers. Mortgage brokers should charge a fixed fee for service for any advice they give to consumers. The current commission structure creates a number of perverse effects, including encouraging borrowers to take a bigger loan than required, and minimising switching. Brokers should be incentivised to have the customer’s best interest in mind, rather than get them to borrow more for longer periods.

Combined Industry Forum’s piecemeal reforms

CHOICE supports the Royal Commission's observations that the Combined Industry’s Forum’s “reforms announced are limited”.[22] We have consistently noted that the package of reforms proposed by industry falls short when dealing with commission structures and the duty brokers owe to clients. CHOICE is a member of the CIF governance committee, acting as an independent consumer advocate. While the announced reforms have been welcome and address some areas of conflicted remuneration, the failure to address the most harmful commission structures is indicative of an industry that ultimately is seeking to continue business as usual.

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[20] Interim Report, p. 301
[21] Interim Report, p.61
[22] Interim Report, p.62

First, the CIF program failed to rectify the inherent problems associated with trail commissions. It noted that trail commissions, which are paid over the entire life of the loan, allow a broker to "provide ongoing support to their customer base".[23] However, the exact nature of this support remains unclear. Clients who require no additional advice are still charged trail for "support" they do not draw upon or require. In addition to this, trail can act as an incentive for the broker to keep their client in an underperforming loan for longer. The Royal Commission's observation about ongoing service arrangements with financial advice that, 'the less the adviser does before the fee is paid, the greater the financial advantage', is equally applicable to mortgage brokers.[24] The financial incentive remains to undertake as little "ongoing support" as possible, to maximize the financial pay-off for the broker.
CHOICE sees trail at its most perverse in businesses established to buy and sell mortgage loan books (the trail payments).[25] The consumer gets no benefit and the possibility of additional service is likely removed when the sale of trail books occur. The buyer gets great benefits: ongoing income for no work and, as implied through industry press, the possibility of making the list more valuable through flogging additional products from insurance to Self-Managed Super Funds.[26] The buying and selling of trail books has very similar characteristics to evidence revealed in the Royal Commission that financial advice licensees, such as AMP and the 'Buyer of Last Resort' policy, have gone to in order to retain grandfathered commissions. Trail commissions or grandfathered commissions are viewed by firms in terms of their future financial payouts - what's in the best interests of consumers is almost always considered as an afterthought, if ever.

The prices for these trail books are staggering. In a quick online search, we found one book sold for $230,000, with a trail income of $11,000 per month.[27] While it could be argued that the consumer doesn't directly pay for these trail payments, that it's a payment from the lender for arranging the loan this ignores the fact that trail contributes to overall lender costs which are inevitably passed on to the consumer. CHOICE strongly believes that if a broker wishes to provide additional support to a customer, then they should charge an upfront fee for the service, rather than receive opaque and high-cost trail commissions.

Second, the CIF reforms failed to capture the full scope of volume-based incentives. As the ASIC review of mortgage broker remuneration found, percentage based upfront and trail based

[23] Combined Industry Forum 2017, Improving customer outcomes: the Combined Industry Forum (CIF) response to ASIC Report 516: review of mortgage broker remuneration.
[24] Interim Report, p.127
[25] For example, http://www.trailbookbuyers.com.au/
[26] See http://www.afr.com/real-estate/residential/vic/mortgage-broker-billiondollar-windfall--as-loan-book-prices-soar-20150415-1mlfu7
[27] http://www.xcllusive.com.au/Sold-Businesses/211-Mortgage-Loan-Book-for-Sale.html. Accessed 23 October 2018. Screenshot available on request.

commissions are both geared towards driving increased loan values, which are the self-confessed root cause of poor consumer outcomes.[28]

Under the industry's proposed reforms a broker or aggregator still stands to gain a higher dollar value in commissions if a consumer borrows more money. For example, a loan of $400,000 with an upfront commission of 0.6% and a trail of 0.15% p.a. would earn a broker $2,400 upfront and $600 p.a. in trail. In contrast, a loan of $600,000 with the same commissions would earn a broker $3,600 upfront and $900 p.a. in trail. Industry has tinkered around the edges in an attempt to deflect attention from its conflicted incentive structure, but so long as commissions exist consumer harm will remain.

Introducing a best-interests duty for mortgage brokers

Mortgage brokers should be legally required to act in the best interest of their customer. Consumers need to have peace of mind that their brokers are acting in their best interest, and the current legislative framework of providing "not unsuitable" loans fails to achieve this. As the evidence presented throughout the Royal Commission showed, lenders view mortgage brokers as simply salespeople for selling their own products. The Commonwealth Bank's requirement that a mortgage broker has to sell a certain number of their mortgages is indicative of this.[29] Purchasing a mortgage is typically the biggest financial decision an Australian consumer will make in their lifetime. In order to act as a bulwark against the pressure for mortgage brokers from lenders, consumers need to have trust that they are acting in their best interest, and not simply acting a conduit for the lender.

What's more, customers are led to believe that a broker will look out for them. Advertising for mortgage broker services claim that brokers will find customers a good quality or even the best loan, even though there is obligation to do so. CHOICE conducted a brief review of online claims made by mortgage brokers and found advertisements in which they stated that brokers would:

- "... be able to help you find the perfect home loan"[30]
- "Save your time and get specialist help to find the best home loan"[31]
- "...we want to find the best loan to fit your personal needs"[32]
- "experienced in getting our clients the best deal on the market"[33]

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[28] ASIC, 2017, 'Report 516 - review of mortgage broker remuneration', p.237

[29] Interim Report, p.58

[30] Finder, https://www.finder.com.au/mortgage-brokers/perth. Searches occurred on 23 October 2018. Images available on request.

[31] Google search, 22 October 2018, https://www.yourmortgage.com.au/mortgage-brokers/find/

[32] Google search, 22 October 2018, https://www.wiseloan.com.au/

In all the above statements, there is a clear implication that brokers act for the customer and help them get a 'perfect' or 'best' loan based on their individual needs. With advertising like this, it's no surprise that consumers think mortgage brokers will get them a good quality loan or act in their best interests.

CHOICE acknowledges that the CIF has announced a 'Customer First Duty'. This already appears to be fraught. We are unconvinced that this duty is enough for brokers to live up to the promises they make to their customers, like that they will arrange the "perfect" loan. It is not possible for a mortgage broker motivated to maximize their upfront and trail commission rewards to simultaneously put their customers' interests first. The customer duty is not as strong as a best interests test, similar to the one that applies to financial advisers. The customer first duty would require a broker to place the customer interests ahead of their own or a lenders' interests - a welcome reform. However, it does not place additional requirements on the quality of broker recommendations. There is no requirement for the broker to recommend a good or the best loan for the customer based on their needs. This quality metric has to be added to any duty in order for brokers to genuinely act for customers.

What is needed is a tangible, legal obligation to make brokers live up to the promise they make to their customers. The best interest duty can be included in the current legal regime through amendment of the National Consumer Credit Protection Act 2009 (Cth). This duty should mirror obligations financial advisors are subject to under the Corporations Act.

Recommendations 2 - 4

- Remove up-front commissions for mortgage brokers and replace these with fixed fees for service to better serve the needs of consumers. These fixed fees could either take the form of lump sum payments or rates based on hours of work required to arrange a loan.
- Ban mortgage brokers from receiving trail commissions for arranging home loans.
- Amend the National Consumer Protection Credit Act 2009 so that all mortgage brokers have to act in the best interests of their clients. This should mirror the obligations for financial advisers in the Corporations Act 2001.

[33] Google search, 22 October 2018 www.switchnowhomeloans.com.au

Reforming the introducer program

CHOICE acknowledges the widespread cases of misconduct that have occurred with introducer programs, especially with the National Australia Bank. This is further evidence that misaligned incentives and remuneration structures lead to poor consumers outcomes. In the National Australia Bank's example, introducers receive a 0.4% commission for recommending consumers to purchase a mortgage. Offering a percentage of loan value as an incentive is ill-suited to remunerate a person for simply introducing a potential lender to the bank. Percentage based commissions are designed to incentivise the sale of larger loans. Coupled with NAB's requirement for introducers to meet volume-based sales targets, the bank created a significant risk that introducers would attempt to convince potential borrowers to take larger, less affordable loans.

In his recent House Standing Committee on Economics appearance, the NAB's CEO Andrew Thorburn sought to absolve the bank of responsibility for the misconduct, using the well-worn 'few bad apples' defence. He claimed that the widespread misconduct, "wasn't about breaking policies or doing the wrong thing; this was fraud from third parties outside the bank and from some of our staff".[34] This viewpoint completely fails to acknowledge the fact that misconduct flows directly from incentive structures promoted and implemented by the National Australian Bank. Incentive structures that are based on commissions drive behavior which is likely to lead to taking advantage of consumers at best, and misconduct, at worst. CHOICE strongly recommends commissions paid to introducers should be prohibited, and introducers should be subject to a duty of care to their customers.

Recommendation 5

- Ban commissions paid to introducers.

Disclosure of mortgage broker remuneration

CHOICE acknowledges that the Royal Commission poses a number of questions around the disclosure of mortgage brokers' obligations and remuneration. CHOICE has recommended the following disclosure obligations, as a minimum.

[34] House of Representatives, Standing Committee on Economics, *Review of Australia's four major banks,* 19 October 2018

Recommendation 6

- Brokers and aggregators should be required to disclose, in plain English:
  - the number of lenders available to the customer, the number of lenders that broker has used in the last year and the top six lenders and percentage of business written in the last year;
  - how much the broker will be paid for arranging the loan with different lenders;
  - any ownership relationships between lenders and the aggregators.

CHOICE has recommended similar disclosure obligations to the Combined Industry Forum - this area is one where industry has put forward a constructive recommendation and committed to consumer testing as part of implementation. CHOICE is encouraging the Combined Industry Forum to look at clear disclosure methods that involves brand logos placed in prominent places so that customers can understand ownership relationships.

It is important to note that disclosure of a conflict does not remove a conflict. Research by the Federal Trade Commission found that mortgage broker disclosure of commissions can actually increase trust in a broker, when it should have led customers to be more critical about the advice.[35] Any proposed changes to disclosure should be rigorously consumer tested to mitigate the risk of a perverse outcome.

Improved disclosure is only a small part of the solution to solve the systemic issue of poor mortgage advice. Without the removal of payments that incentivise brokers to put their or lender needs first and mandating a best interest duty for brokers, such changes to disclosure will likely have a negligible effect on both consumer outcomes and minimising misconduct.

Broadening the BEAR

CHOICE supports an expansion of the Banking Executive Accountability Regime (the BEAR). The current legislation is restricted in scope. Its focus is on prudential regulation, including capital liquidity requirements, and risk management protocols. For the vast majority of misconduct revealed in the Royal Commission - from fees-for-no-service, to selling unclaimable insurance, to breaches of responsible lending laws - executives would be unlikely to suffer any consequences under the BEAR, as these breaches do not touch upon prudential issues. In

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[35] James Lacko and Janis Pappalardo, 2004, 'The effect of mortgage broker compensation disclosures on consumers and competition: a controlled experiment", Federal Trade Commission, https://www.ftc.gov/reports/effect-mortgage-broker-compensation-disclosures-consumers-competition-controlled-experiment

order to prevent further misconduct and improve consumer outcomes, the BEAR needs to be expanded to include conduct regulation.

Recommendation 7

- That the BEAR framework be expanded in three important ways:
    - to include conduct regulation;
    - to extend 'accountable persons' to include senior managers responsible; and
    - to extend the scope to include insurers and non-prudentially regulated firms.

This is the current structure in the United Kingdom, of which the Australian legislation was originally based upon. In the United Kingdom, the Government gave new powers to the prudential regulator, the Prudential Regulation Authority, as well as the consumer and conduct regulator, the Financial Conduct Authority. Crucially, the United Kingdom regime requires managers to take reasonable steps to prevent regulatory breaches in the areas of the bank for which they're responsible and requires senior managers to act with integrity, pay due regard to the interests of customers and treat them fairly. These components are missing from the Australian regime.

By extending the BEAR regime to senior managers, it will mean that there is greater accountability and responsibility for misconduct. As the Financial Conduct Authority recently noted,

> "A robust individual accountability regime can reinforce acceptable standards of behaviour and be a critical factor in deterring misconduct. Ultimately, its main aim is to drive culture change by making Senior Managers accountable and by applying baseline standards to all financial services staff."[36]

The extension of the BEAR to conduct regulation will ensure that staff from financial services firms will have consumers' long-term interests at the core of their decision-making. It is an important way to shift the current culture of selling products to consumers to maximise revenue to instead begin considering the financial wellbeing of consumers.

[36] Financial Conduct Authority, 2017, 'Individual Accountability: Extending the senior managers and certification regime: cost-benefit analysis' p. 33 https://www.fca.org.uk/publication/research/cba-extension-senior-managers-certification-regime.pdf

Expand product intervention powers to include remuneration practices

CHOICE strongly supports increasing the proposed product intervention powers to include remuneration practices for a risk of consumer detriment. As the Royal Commission evidence has consistently revealed, remuneration practices within a financial services firm is a leading cause of misconduct in the industry. ASIC should have the ability to proactively respond to harmful products in the market that it views are driven by improper remuneration practices, such as commissions or conflicted remuneration. The ability of ASIC to intervene should be an essential tool in the regulator's arsenal, and we encourage the Royal Commission to consider this proposal.

Recommendation 8

- Expand proposed product intervention powers for ASIC to include remuneration practices that risk encouraging behaviour that is likely to result in consumer detriment.

(Un)balanced scorecards

CHOICE strongly agrees with the Interim Report's conclusion that,

> "despite the scorecard's complexity, sales lie at its heart and the chief purpose of the whole incentive program remains to enhance the bank's 'overall results'".[37]

Balanced scorecards are a wolf in sheep's clothing - these scorecards merely pay lip-service to being 'customer focused', yet still reward staff for selling products to consumers. This is evidenced in ANZ's balanced scorecard, where still over half of the scorecard is based on financial performance and sales.[38] This is also shown in Westpac's balanced scorecard, where three of the four categories under 'Customer Measures' pertain to financial performance.[39] This intentional obfuscation of balanced scorecards has been highlighted by the Financial Conduct Authority, who argue that,

[37] Interim Report, p.313
[38] Interim Report, p.313
[39] Interim Report, p. 314

> "Sales targets might be given less prominence by changing terminology, for example where staff are given objectives for how many 'customer needs' are met, but this might still have the same effect as a sales target."[40]

CHOICE strongly supports the use of performance evaluation - across all levels of the firm, from front-line staff, to middle managers, to senior executives - that is not tied to sales or selling products to individuals. Given the banks track record of misconduct, these scorecards should be made public, in clear English. This is an essential change in ensuring that banks are considering the long-term interests of consumers, and not simply viewing them as a vehicle for selling more unsuitable products.

Financial advice remuneration

Ongoing service arrangements

Reforms need to be made to ongoing service arrangements within the financial advice industry. The current remuneration structure for advisers is not-well positioned to encourage them to act in the best interests of their clients. CHOICE strongly affirms the Royal Commission's conclusion that 'advisers often treated ongoing service arrangements as though they were nothing but trail commissions for the advice that had already been given'.[41] This sentiment is shared by ASIC Commissioner Peter Kell,

> "if ongoing services are improperly applied, then they do, unfortunately have some similarities with some of the more problematic aspects of commissions, being that they are recurring, they can be invisible to the customer from a practical point of view – and there may be no clarity around what exactly the customer is getting or supposed to get in – in return for this payment."[42]

It is evident from the widespread occurrence of fees-for-no-service that financial advice licensees and advisers cannot be trusted to actually provide services in these ongoing arrangements. Greater safeguards for consumers need to be introduced. These ongoing arrangements contain an inherent and ever present temptation for financial advisers - the less time and effort an adviser spends on a customer, the greater the financial payoff. This is exemplified in evidence from the Royal Commission where for BW Financial Advice Limited, a

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[40] Financial Conduct Authority, 2015 'Risks to customers from performance management at firms. Thematic review and guidance for firms.' https://www.fca.org.uk/publication/guidance-consultation/gc15-01.pdf
[41] Interim Report, p. 122
[42] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, transcript, 16th April 2018, p.1032

subsidiary of the Commonwealth Bank, the 'mere offer of an annual review was sufficient for the fee to be charged.'[43]

Ongoing fees for financial advice should be banned, and replaced with a fixed fee for service. Banning ongoing fees and forcing advisers to prove their worth by having to pitch for repeat customers would remove the conflicts that drive poor outcomes in the sector. This places the power back into the hands of consumers, who can judge the value of the financial advice when it occurs, and are not simply charged for something as vague as an 'offer of a review'. This would greatly improve transparency over fees paid and would likely prompt people to end payments where they no longer believed they were getting appropriate value for money.

Recommendation 9

- Ban ongoing fees for financial advice and replace these with a fixed fee for service.

Banning grandfathered commissions

The Future of Financial Advice (FOFA) reforms were predicated on a clear understanding that commission-based payments led to conflicted advice, i.e. advisers giving advice not in the best interests of their clients. The original intent of grandfathering was to "facilitate a smooth transition to the new regime for industry whilst ensuring the ban on conflicted remuneration commenced as soon as practicable."[44] What the Royal Commission has shown is that members of industry have sought to prolong the existence of conflicted remuneration by taking steps to evergreen conflicted remuneration rather than remove it entirely.

The evidence which came to light during the hearings showed financial advice licensees have systemically prioritised maintaining grandfathered commissions over acting in the best interest of their customers. Including:

- Evidence that AMP management made a concerted effort to structure their business to allow "orphan" clients to continue to be charged grandfathered commission, even though their clients changed advisers.[45]
- Evidence that even five years after the passing of FoFA, 60-70% of fees that AMP pays to its advisers are commissions, rather than fees-for-service.[46]

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[43] Interim Report, p.129
[44] Treasury, 2018, 'Key reforms in the regulation of financial advice', p.8
[45] Royal Commission transcript, 20th April 2018, p.1138
[46] Royal Commission transcript, 20th April 2018, p.1153

- Evidence that a subsidiary of ANZ, RI Advice, purchased advisers without undertaking appropriate due diligence, before the 1 July 2013 FOFA deadline, to ensure that they received ongoing grandfathered commissions. This included offering $150,000 to one financial planner, despite the fact he had failed his initial competency exam, continued to provide consistently poor advice, and received his first complaint just three months after joining ANZ.[47]

These examples are not isolated incidents. They exist on an industry-wide level. Financial service licensees have systematically endeavored to profit from existing pre-FoFA customers. It has been unequivocally shown that commissions distort the quality of financial advice offered to consumers, and grandfathered commissions are no exception. The current exemption has helped to foster the attitude that advisers are justified in continuing to reap these commissions. The banning of all grandfathered commissions should occur as soon as possible. Over five years has passed since the FoFA reforms, and industry has been provided ample time to adjust to a new business model. Change will only come from a legislated ceasing of all grandfathered commissions.

Recommendation 10

- Cease grandfathered commissions.

Removal of asset-based fees

CHOICE is strongly supportive of the removal of asset-based fees in financial advice. Asset-based fees are calculated as a percentage of funds under management. These fees obscure the true cost of the service provided, and share many of the harmful characteristics of commissions or ongoing service arrangements. These fees bear no relationship to the work actually done by the financial adviser or the quality of that work.

At every stage of the financial advice process, financial institutions ‘clip the ticket’ of their client’s hard earned-savings. Consumers can be hit with an asset-based fee when they engage with an adviser. They are hit with an asset-based fee when they access an investment platform. They are hit with an asset-based fee for each product they invest in on that platform. With vertical integration, consumers can be slugged three separate asset-based fees, which are obfuscated by vague terms. Further, asset-based fees penalise those with more savings. For example, with a “platform administration fee” of 0.75%, an individual with $200,000 invested in the platform would pay double the fees compared with another individual who has $100,000 invested in the

[47] Royal Commission transcript, 20th April, p.1492

exact same platform. Asset-based fees in financial advice should be banned, and be replaced with a fixed fee for service.

CHOICE supports the Royal Commission's assertion that platform fees, which charge a percentage based on funds under management show "an absence of effective competitive pressure".[48] These platforms are often owned by the adviser's entity, and there are no competitive drivers at all for the adviser to find either a more cost-effective or more suitable platform that may be in the best interest of their client. Further, the charging of platform fees are largely invisible to consumers, and are often deducted automatically from a client's platform account, with a client's express consent.

The needs to be much greater transparency for the charging of these platform fees. First, any platform-based fees need to move from asset-based fees to a fixed fee for service. Second, these fees cannot be automatically deducted from a client's platform account, without the express consent of the client. Third, in order to introduce competition to platform operators, financial advisers must be legally obligated offer a range of platform providers, of different ownership structures.

Recommendations 11-13

- Ban asset-based fees in financial advice.
- Prevent fees associated with financial advice platforms from being automatically deducted from a client's platform account, without the express consent of the client.
- Introduce a legal obligation for financial advisers to offer a range of platform providers, of different ownership structures.

Life insurance commissions

CHOICE acknowledges the recent legislative changes to both cap upfront commissions and to introduce clawbacks for life insurance. The reforms are an improvement from previous arrangements, however, they do not remove the conflict, they simply make it slightly less profitable. A 2014 ASIC review of retail life insurance found systemic problems within the industry.[49] 37% of advice failed to prioritise the needs of the client and comply with the law. Further, high upfront commissions are strongly correlated with poor advice; 45% of advisers who were paid through up-front commissions failed to comply with the law. The statutory carve-out for life insurance commissions creates misaligned incentives, and results in poor consumer outcomes.

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[48] Interim Report, p.136
[49] ASIC, 2014, 'Report 413 - Review of retail life insurance advice', p. 5-7.

Given the overwhelming evidence of consumer harm related to commission-based sales, commissions need to be permanently banned, as they are for other types of financial advice. ASIC should be directed to use its regulatory power to introduce a glide path to zero for the removal of life insurance commissions, with the aim of giving advisers a reasonable timeframe to develop new revenue streams while protecting consumers from further exploitation.

Recommendation 14

- Ban commissions in the life insurance industry.
  - At a minimum, the exceptions for general insurance and life risk insurance should be removed from the ban on conflicted remuneration in Division 4 of Part 7.7A of the *Corporations Act 2001*.

3. Penalties

Reforms to remuneration must be coupled with increases in civil penalties. Culture comes from the top down, and executives and other senior managers must manage their workers and their organisations in a way that does not encourage poor behaviour and non-compliance.[50] Changes to remuneration discussed above can be used to target executives and other senior managers to make poor business practices less rewarding to them personally. However, aside from their personal remuneration, executives and other senior managers have a vested interest in maximising the profitability of their organisations.

The pursuit of short-term profit at the expense of client outcomes has been the steering the activities of banks, resulting in dishonest, exploitative and illegal behaviour. The Interim Report catalogues this in detail, concluding that all the poor conduct identified in the report financially benefited the entities concerned.[51] Banks are unconcerned with how profits are achieved, as they face little competitive pressure and little threat of failure of their enterprises.[52] Therefore, non-compliance must challenge the revenue and profitability of the organisation for executives and senior managers to be properly incentivised to ensure that a culture that values serving consumer needs is instilled in their organisation.

This requires robust civil penalties set at a sufficient level to challenge the profitability of an organisation. As the Interim Report notes, “regulator[s] must do whatever can be done to ensure

[50] Interim Report, p.308
[51] Interim Report, p. 301
[52] Interim Report, p. 269

that breach of the law is not profitable".[53] If poor business practices are likely to result in hefty fines, executives and other senior managers will be incentivised to create a culture among their workers that takes compliance and consumer well being seriously. However, it is clear from the Commission's work that penalties are not sufficient at the moment.

CHOICE supports the recommendation of the ASIC Enforcement Taskforce Review to expand the civil penalty regime to the provisions included in Table 1 in the appendix and to increase penalty units across all the ASIC-administered legislation. For corporations, this creates a maximum penalty of 50,000 penalty units (currently $10.5 million), three times the value of benefits obtained or losses avoided or 10% of annual turnover in the 12 months preceding the contravening conduct – whichever is greater.[54]

However, CHOICE believes that the recommendation of the Taskforce should be modified in two ways. First, CHOICE recommends that penalties should, at a *minimum*, equal the value of benefits obtained or losses avoided. This will ensure that a breach of the law is not profitable. Second, CHOICE does not agree with the Taskforce that penalties for corporations should be capped at million penalty units ($210 million). A cap, even one at a high level such as this, undermines the strength of the scheme devised by the Taskforce: that contravention can result in penalties which are, at the very least, three times greater what companies sought to gain by breaching the law. It must be noted that Australian financial institutions are very profitable, and even a penalty of $210 million could be borne with relative ease by the largest market players. CBA, for example, posted profits of $9.233 billion for the 2018 financial year.[55]

The Interim Report has also criticised the culture of the regulators, which it believes have too heavily favoured negotiating outcomes over taking court action.[56] CHOICE believes that the inadequacy of civil penalties has contributed to this. Court action is expensive and can be time-consuming – especially considering the asymmetric resources between regulators such as ASIC and large banks. Low penalties make court action even less appealing, as even successful court proceedings fail to sufficiently penalise breaches. Enforceable undertakings therefore appear more attractive. For example, in the 2017 financial year, ASIC completed 55 civil litigations resulting in $3.9 million in penalties – or $71,000 per action.[57] Meanwhile, it accepted seven enforceable undertakings resulting in $5.1 million in community benefit payments.[58]

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[53] Interim Report p.296.
[54] The Treasury, 'ASIC Enforcement Review Taskforce' December 2017, p. 73.
[55] See https://www.commbank.com.au/guidance/newsroom/cba-fy18-results-201808.html
[56] Interim Report, p. 293-4
[57] ASIC, Annual Report 2016-2017, p.31. Available at https://download.asic.gov.au/media/4527819/annual-report-2016-17-published-26-october-2017-full.pdf
[58] ASIC, Annual Report 2016-2017, p.32

Of course, the community benefit payments that can result from an enforceable undertaking are lower that the civil penalties available. Nevertheless, enforceable undertakings are less resource and time-intensive, result in publicity of the wrongdoing and are able to financially sanction the party concerned, using the funds to help prevent consumer detriment in the future. Banks are aware of this dynamic as well, which further increases their bargaining power vis-à-vis regulators. This affects not only their leverage in enforceable undertaking negotiations, but also the decision to pursue an enforceable undertaking in the first instance.

Recommendations 15 & 16

- That the Federal Government urgently act on the recommendation of the ASIC Enforcement Taskforce Review to expand the civil penalty regime.
    - Obligations in section 912A of the *Corporations Act 2001* must apply to all aspects of the provision of insurance, including the handling and settlement of insurance claims.
- That the Federal Government urgently act to increase penalties across all ASIC-administered legislation to the same level.
    - For corporations, penalties should be raised to be the greater of 50,000 penalty units (currently $10.5 million), three times the value of benefits obtained or losses avoided or 10% of annual turnover in the 12 months preceding the contravening conduct.
    - Penalties should not be capped in a way that limits them from acting as an effective deterrent, i.e. at a minimum, penalties for breaches must at least equal the value of the benefits obtained or losses avoided. If this figure cannot be calculated, penalties should be the greater of 50,000 penalty units or 10% of annual turnover in the 12 months preceding the contravening conduct.

4. Enforcement

Resources and enforcement action

Both restrictions on remuneration and increases in civil penalties will only be effective in changing incentive structures for banks and financial services industries, and therefore business practices and culture, if they are enforceable. In order for systemic problems in the industry to be addressed, businesses, their executives and managers, their shareholders and their workers must believe that a) poor practices will be investigated by regulators and b) findings of wrongdoing will result in hefty penalties. This requires a prominent role for regulators. However,

the Interim Report has criticised the regulators for not taking court action against banks for breaches. CHOICE believes that these shortcomings primarily reflect the inadequacy of proper tools and resources.

First, the resources in the financial industry far outstrip those of the regulators responsible for monitoring their behaviour. Table 1.1 below illustrates this. It compares the income of ASIC, APRA and the four largest banks. As it shows, ASIC's income of $326.4 million pales in comparison to the $25.9 billion of CBA. Of course, a bank, especially the market leader in CBA, should be expected to have a larger income than the regulator. However, these figures illustrate just how stark the asymmetry is. Regulators, when going to court, face opponents with much greater resources, which can dedicate more of these resources to preparing for litigation, and which are able to prolong and delay court proceedings. If there is an expectation that ASIC and APRA should increase their use of expensive litigation against well-resourced opponents, then this demands an increase in their resources. Larger civil penalties will also make court proceedings more attractive for regulators, as discussed above.

Table 1.1 – Operating income of regulators and banks, FY2017

Organisation	Income ($m)
APRA[59]	149.0
ASIC[60]	326.4
National Australia Bank[61]	18,024
ANZ[62]	20,489

[59] APRA Annual Report 2016-2017, p. 83. Available at https://www.apra.gov.au/sites/default/files/apra_annual_report_2016-17_0.pdf

[60] ASIC Annual Report 2016-2017, p.129. Available at https://download.asic.gov.au/media/4527819/annual-report-2016-17-published-26-october-2017-full.pdf

[61] National Australia Bank Annual Financial Report 2017, p. 6. Available at https://capital.nab.com.au/docs/NAB-2017-annual-financial-report.pdf

[62] ANZ 2017 Annual Report, p. 14. Available at https://shareholder.anz.com/sites/default/files/2017_anz_annual_report.pdf

Westpac[63]	21,802
Commonwealth Bank[64]	25,940

CHOICE believes that enforceable undertakings, whilst not suited to some circumstances and over-utilised currently, do have an important role to play in a regulator's toolbox. They provide flexibility to regulators to exercise discretion in how they approach breaches and non-compliance.[65] As discussed above, court proceedings can be lengthy, delaying consumer access to remediation. Enforceable undertakings can be a more timely response that minimises consumer detriment. The significance of this should not be undervalued. In the 2017 financial year, ASIC secured $837.7 million in compensation or remediation from its seven enforceable undertakings.[66]

However, the current options of either enforceable undertakings or court action are not appropriate in all circumstances. Enforceable undertakings rely on a negotiated outcome between the financial service provider and the regulator, and can result in deadlock. At times, the regulator may be unsatisfied with the penalties financial service providers are willing to accept. Therefore, regulators need other real-time powers to direct remediation quickly and, if required, at a later date back this up with court enforcement. The ASIC Enforcement Taskforce Review makes this and other recommendations for improving the tools for ASIC to ensure that they are fit for purpose. CHOICE believes that all of these recommendations must be implemented in full. The Government's response to the Taskforce agrees or agrees in principal with all of the recommendations.[67]

Consumer representation in ASIC

[63] 2017 Westpac Group Annual Report, p.70. Available at https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/ic/2017_Westpac_Annual_Report_Web_ready_&_Bookmarked.pdf

[64] Commonwealth Bank Annual Report 2017, p. 141. Available at https://www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/annual-reports/annual_report_2017_14_aug_2017.pdf

[65] https://download.asic.gov.au/media/2976014/rg100-published-19-february-2015.pdf p.6

[66] Ibid, p. 32.

[67] The Australian Government, 'Australian Government response to the ASIC Enforcement Review Taskforce Report' April 2018

CHOICE also wants to note that both ASIC and APRA have performed an important service in their capacity as regulators. They have investigated and exposed malpractice by the banks and financial services industries, which is apparent from the evidence presented to the Commission. The full extent of the industries' dishonest and illegal behaviour would not be known without the work of the regulators. In addition to their investigations, the regulators have also provided research and data that has been used extensively by the Commission and other stakeholders, including CHOICE, throughout the proceedings.

CHOICE strongly supports increased consumer representation in the governance structures at ASIC. ASIC's outgoing Deputy Chairperson, Peter Kell, who has background in consumer protection, has been instrumental in championing consumer issues, and reforming the financial sector. It is essential that this consumer focus continues. The *Australian Securities and Investments Commission Act 2001* does not currently require that at least one Commissioner must have consumer protection expertise, which stands in contrast to the ACCC's governing legislation, which requires that at least one member of the Commission have a consumer protection background.[68] There is a longstanding convention that this person be the Deputy Chair of the ACCC. CHOICE recommends that the ASIC Act be amended to require that at least one member of the Commission have consumer protection experience, and that this member be either the Chairperson or Deputy Chairperson.

The structure of the regulator

It remains CHOICE's position that with the right suite of investigation, compliance and enforcement powers, coupled with adequate resourcing and high penalties for breach, ASIC will be well-equipped to deal with existing challenges.

However, CHOICE recognises that the Commission is investigating the question of whether regulator responsibilities should be changed, or whether ASIC's current remit is too large. CHOICE prefers the approach outlined above, of strengthening ASIC rather than restructuring it. However, if the Commission is persuaded that ASIC's current remit is too large we recommend as a first option for the Commission to consider the feasibility of separating responsibility for retail financial services from corporations and markets regulation across two independent regulators. This option could only be pursued with confidence if the regulator responsible for retail financial services was adequately resourced and provided with sufficient power (in line with our recommendations for increased powers for ASIC).

[68] *Competition and Consumer Act 2010* (Cth), s7(4), 'At least one of the members of the Commission must be a person who has knowledge of, or experience in, consumer protection'.

Profit-driven behaviour

CHOICE would like to address the Interim Report's suggestion that 'complicated' can result in non-compliance:

> The more complicated the law, the easier it is for compliance to be seen as asking 'Can I do this?' and answering that question by ticking boxes instead of asking 'Should I do this? What is the right thing to do?' And there is every reason to think that the conduct examined in this report has occurred when the only question asked is: 'Can I?'.[69]

CHOICE disagrees with this assessment. As the illegal behaviour exhibited by the industry clearly illustrates, the conduct examined by the report did *not* occur when the only question asked was 'can I do this?' In many of the cases, the definitive answer for this question was 'no' – nevertheless, the conduct continued. Rather, it has been in the pursuit of profit that "banks have gone to the edge of what is permitted, and too often beyond that limit".[70] Far from asking 'can I do this?', the calculation that the banks have made consistently is 'how profitable is this?'

As discussed above, cultural problems within the banks has been driven by incentive structures – structures that can be addressed through reforms. Whether banks seek to 'do the right thing' or ask 'should I do this' depends on appropriate incentive structures being in place. This requires a move away from unenforceable industry-written self-regulatory codes, well-resourced regulators, with appropriate tools and remit, which can pursue civil penalties that significantly threaten the profitability of banks.

Recommendations 17 and 18

- ASIC and APRA should be appropriately resourced to support increased volumes of litigation.
- All of the recommendations of the ASIC Enforcement Taskforce Review should be implemented in full, as a matter of urgency.

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[69] Interim Report, p.290
[70] Interim Report, p.269

5. Ensuring consumer redress

CHOICE maintains that in a properly functioning financial services sector the focus should be on harm prevention and empowering regulators as a first resort. However, when the system fails the sector as a whole should be responsible, through the funding of a last resort compensation scheme, to ensure consumers are not left financially ruined and without remedy.

The *Corporations Act 2001* and *National Consumer Credit Protection Act 2009* impose an obligation on licensees to provide compensation to consumers for certain losses incurred. However, there remain circumstances when consumers are left without compensation, typically when financial service entities become insolvent. This risk is heightened in an environment where large financial providers with significant capital holdings move away from the advice sector. In their place is likely to be a series of smaller advice businesses who is many cases will not have the resources to compensate consumers for improper advice which leads to loss. This is best evidenced in the collapse of Dover Financial Services, an entity that arguably folded due to revelations of misconduct made public in their appearance before this Commission. Dover Financial Services had an estimated 40,000 to 50,000 clients.These clients are now not able to access external dispute mechanisms, such as the Australian Financial Complaints Authority. If any of these clients had a complaint against the company, they will struggle to get fair compensation.

CHOICE supports the observations made by the Ramsay Review as to the benefits of a compensation scheme of last resort.[71] The scheme should be designed to ensure it is properly funded by financial firms and capable of compensating consumers in the event of failure. Such a scheme should shift the cost of misconduct away from the community and onto the sectors that are causing harm. An industry funded compensation scheme of last resort will firmly place an economic imperative to lift standards at the board, owner and professional body level of this sector.

Recommendation 19

- The Commission recommend establishing a compensation scheme of last resort in line with the findings of the Ramsay Review

[71] September 2017, Ramsey Review, Supplementary Final Report – Review of the financial system's external dispute resolution and complaints framework‟, p.41, available at http://192.195.49.161/ConsultationsandReviews/Reviews/2016/Review-into-Dispute-Resolution-and-Complaints-Framework/Final-Report

CHOICE

Appendix

Complete list of new civil penalty provisions

Corporations Act
601ED(5)
670A
727
728
791A
792B
820A
821B
853F(2)
904C(1)
905A
911A

CHOICE

911B
912D
920C(2)
922M
941A
941B
946A
952E
952H
981B
981C
993D (3)
1012A
1012B
1012C
1017BA

1017BB(1)
1020A(1)
1021E
1021G
1309(2)
General Licensee Obligations
792A(a), (c), (d), (e), (f), (g), (h), (i)
821A (aa), (a), (c), (d), (e), (f), (g), (h)
904A(b), (c)
912A(a), (aa), (ca), (d), (e), (f), (g), (h), (j)
Credit Act s47 (a), (b), (e), (f), (g), (h), (i), (j), (k), (l), (m)

Insurance Contracts Act 1984
13(1)
33C(1)
Credit Code Obligations

24
39B(1)
154
155
156(1)
174(3)
179U
179V